



California Outlook: Agriculture 1981



May 29, 1981

AN OVERVIEW

California agriculture will set record dollar levels for both gross and net farm income in 1981. Gross farm income will advance about 8.2 percent to \$15.5 billion. Increases in production expenses should moderate from the double-digit rates of the past two years—growing by about 8 percent in 1981 to \$11.9 billion. Contributing to the deceleration are changes in crop mix, a reduction in the number of livestock on feed, and a slowing of oil price increases. As a result, net farm income is expected to rise by about 9 percent to nearly \$3.6 billion in 1981 (see Figure 1). Still, when adjusted for inflation (GNP deflator), net farm income will be about 1 percent below last year's adjusted level.

Cash receipts from the sale of crops will rise more rapidly than those for livestock in 1981 (see Table 2). Income from field crops and horticultural products is expected to register particularly strong growth. Gains reflect both higher prices and expanded acreages for wheat and other field crops.

Consumer food prices are expected to rise rapidly in the second half of 1981, resulting in an increase of 12 to 15 percent for the year. The increase will be brought about by tighter supplies of some important food items and a widening of farm-to-retail price spreads. Changes in retail prices are being increasingly affected by rising marketing costs rather than by price movements at the farm level.

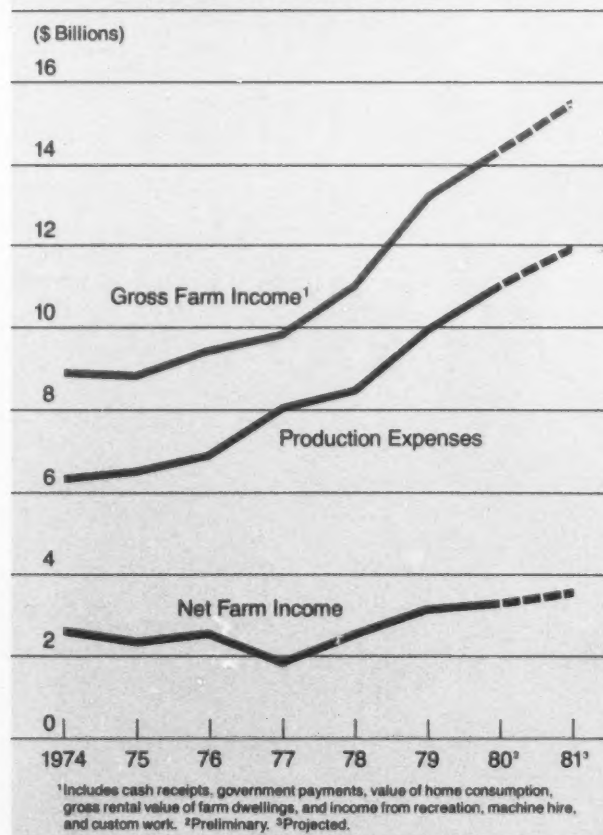
As California's traditional agricultural areas become more urban, competition grows for land, water, and other resources. Unless profitability of food and fiber production increases, or legal prohibitions against the shift of farmland out of agriculture are enacted, California's agricultural and farming resources will continue to be diverted to other uses.

Proposals of the current U.S. Administration call for diminishing government regulation of agricul-

ture and greater reliance on free market forces—a trend which should underlie agricultural policy over the next four years.

The long-term outlook for California's dairy industry remains favorable, although rising costs and a recent cancelation of the expected federal support price increase will slim profit margins and discourage further expansion of dairy herds.

FIG. 1 FARM INCOME AND PRODUCTION EXPENSES IN CALIFORNIA, 1974-1981



EXTERNAL FACTORS

As the nation's leading agricultural state, California is keenly affected by national and international economic and political developments. Economic factors influencing the farm outlook for 1981 include expected slow economic growth or recession in the state's major markets—the United States, Western Europe, and Japan; the prospect of continued high domestic inflation and interest rates; tight monetary and fiscal policies; and a stronger U.S. dollar.

Due to high interest rates and concern over weak demand, firms in the food delivery chain have been paying close attention to inventory levels. Buyers of raw farm products have also become more reluctant to make forward contracts. Collectively, these business decisions are shifting the burden of price risk back toward farmers.

Moreover, U.S. government policies toward agriculture are changing. Administration proposals for both the 1981 omnibus farm bill and the 1982 federal budget call for diminishing government regulation of agriculture and greater reliance on free market forces. The omnibus farm bill reflects the Administration's contention that world commodity markets have improved in recent years and farmers need less protection than in the past. The Reagan Administration's fiscal 1982 budget for the Department of Agriculture proposes to limit direct lending programs and to bring subsidized loan rates for farmers closer to market levels.

For the omnibus bill, specific proposals include:

- Setting a minimum floor of 70 percent of parity for milk price support rather than the current 75 percent level.
- Ending target prices and deficiency payments for cotton and most grains. At the same time, loan rates would rise modestly.
- Changing the grain reserve system to end release and call prices, replacing them with a single trigger price to be set periodically by the Secretary of Agriculture. Also, the size of the program would be limited.
- Changing the mechanism used to set the rate of interest paid on loans to grain farmers in the reserve program. Rates would be based on the cost of funds to the U.S. Treasury and, if the market price reached the trigger price, the full market rate would be charged for loans along with a storage fee for grain.
- Eliminating school lunch program benefits for those with incomes above 180 percent of poverty level and reducing program benefits to those in the 130 to 180 percent range.

The Administration's proposals have encountered opposition in Congress; however, a trend

toward a growing market role is likely to underlie agricultural policy over the next four years.

CONSUMER PRICES

U.S. consumers altered their buying habits during the recent economic slump. Households are attempting to economize on food bills by seeking good buys and eating out less. Overall, food sales—when adjusted for inflation—are currently lagging year-earlier levels and food demand is expected to remain lackluster throughout the year.

Consumer food prices, which have not increased as much as overall inflation in recent years, are expected to grow rapidly during the second half of the year—resulting in an increase of 12 to 15 percent for the year as a whole. The more rapid rise is due to a combination of tightened supplies of some important food items and a widening of farm-to-retail price spreads. Growing spreads are due primarily to higher transportation, energy, interest, and labor costs. Changes in retail prices are being increasingly affected by these marketing costs rather than by price movements at the farm level. Farm price increases for 1981 will account for only one-third of the overall increase in retail food prices.

Retail meat prices will be sharply higher by year's end due to declining beef and pork production. This will lead to greater demand for poultry and higher poultry prices. Overall, these higher prices will have a significant impact on consumers since red meat and poultry represent about 35 percent of food expenditures. But the increases must be measured against the fact that in early April, at their lowest point, retail prices for both ground beef and choice cuts were 10 to 20 percent below 1980 levels.

Canned and frozen food prices will also increase substantially in 1981, due partly to reduced plantings of crops grown for sale to processors, but more importantly to rising costs of transportation, packaging, and energy used in processing.

DAIRY AND CATTLE PRODUCER RANKS DECLINE

Milk will continue to be the state's leading cash commodity, with total sales approaching \$1.8 billion in 1981. Cattle and calves will be second in importance, with sales of about \$1.4 billion. Milk and cattle producers, however, face a cost-price

squeeze this year, which will be likely to force some producers out of business.

Profitability for milk producers will be reduced by a change in federal milk support price regulations and rising costs. For the past few years, the federal support price for milk has been automatically ratcheting up along with the Index of Prices Paid by Farmers, a measure established by the U.S. Department of Agriculture. Because California's milk pricing mechanism is linked to the federal support price, milk prices in the state also have moved up. The impact on California has been a 3 to 4 percent annual expansion of the state's dairy herd, increased production per cow, and a swelling of milk supplies—all at a time when consumption of fluid milk and other Class I dairy products has been declining.

At current production levels, the state's processing capacity is strained, and at times milk has had to be shipped out of state for processing. Added processing capacity for soft cheeses, which are gaining in consumer popularity, could reduce the need for out-of-state processing and increase sales through commercial channels. In its absence, increasing quantities of milk are being processed into butter, hard cheese, and milk powder for sale to the federal government.

Nationwide, the government last year stockpiled dairy products equivalent to almost 9 billion pounds of milk at a cost exceeding \$1.3 billion. And the stockpile is growing. It is likely that government expenditures supporting milk prices in 1981 will again surpass \$1.3 billion.

In March, President Reagan signed into law new legislation canceling the last adjustment of the federal price support for milk under a farm bill of the previous administration. As a result, increases in California milk prices will not keep pace with growth in production costs, and profit margins will fall. This will discourage further expansion of dairy herds. The cost-price squeeze will induce producers to cull more cows and reduce the feeding of the concentrates that increase a cow's milk yield. Growth of the state's milk supply will slow substantially as 1981 progresses, with production in the last quarter expected to be below year earlier levels.

It is likely that some producers will be forced out of operation. New, highly leveraged Grade A producers with little or no production-quota allocation, Grade B dairies, and high-cost producers will be particularly vulnerable. The value of milk cow replacements is expected to decline, and the value of milk quota should increase. Although 1981 will mark a change in the trendline of profitability, the long-term outlook for California's dairy industry nevertheless remains favorable.

Unlike milk producers, the state's cattle pro-

ducers and feeders experienced a cost-price squeeze through much of 1980. Unprofitable market prices are expected to prevail through the first half of 1981 due to an unexpectedly large supply of heavyweight cattle and soft consumer demand. Average prices for slaughter steers and feeder cattle through the first quarter of 1981 fell below levels for the same period of 1980, while production costs continued to rise.

In all the major cattle feeding states, rising feed costs, unprofitable returns, and weak consumer demand have brought about a drop in the number of cattle on feed. Placements of cattle into feedlots during the first quarter of 1981 were about 4 percent below those in the same period in 1980. This drop suggests a shrinking supply of beef during the spring and summer months of 1981, with production during the spring quarter expected to decline about 6 percent from levels in the spring of 1980. With reduced supplies, prices for slaughter steers will likely average about \$73 per hundred-weight during the second half of the year, up from the first half average of \$66.

The number of cattle feedlots operating in California has declined following a prolonged period of economic hardship for the industry. Since 1979, 29 feedlots have gone out of business, reducing the state's feeding capacity by about 20 percent. In March 1981, feedlots were operating at about 35 percent of capacity—down from 44 percent a year earlier. However, feedlots in the Sacramento Valley and northern counties were using only about 10 percent of capacity while those in the Imperial Valley averaged 68 percent.

Feeding operations are becoming concentrated in the Imperial and central San Joaquin Valleys, partly due to more favorable weather conditions and proximity to markets. While these two regions represent 60 percent of the state's feedlots and 71 percent of its total feeding capacity, they currently account for about 80 percent of its cattle on feed. Continuing narrow or negative profit margins and relatively low utilization in many areas signal further declines in feedlot numbers and capacity in 1981.

CANNING INDUSTRY PROFITS EXPECTED TO IMPROVE

For the past two years, the state's canning industry has been plagued by low profitability. Due to larger than expected supplies of raw products, inventories have grown beyond desired levels during a period of record high interest rates and rising production costs. Major components of the state's canned product mix are tomatoes and tomato

Table 1. Processing Vegetable Crop Plantings in California, 1979-1981 (thousands of acres)

Crop	1979	1980	1981 ¹	Percent Change 1980-1981
Processing Tomatoes	256.0	211.2	205.0	-3%
Asparagus	26.4	27.9	27.3	-2
Green Lima Beans	30.7	20.4	19.0	-5
Strawberries	11.5	11.0	10.9	-1
Winter Spinach	11.1	10.8	7.8	-28
Snap Beans	7.3	4.8	4.1	-11
Green Peas	11.3	7.0	3.8	-46
Cucumbers for Pickles	4.6	3.7	3.3	-11
Totals	358.9	296.8	281.2	-5%

¹Contracted acreage as of March 1.

products, cling peaches, fruit cocktail, and pears. While some canners specialize in tomatoes, the major canning operators produce full lines of fruits and vegetables as well. Until mid-1980, excess supplies of canned tomatoes and tomato products and their unprofitable wholesale prices were the focus of the industry's attention. However, its current concern is with canned fruits.

Tomatoes

The 6.4 million ton crop of tomatoes in 1979 produced burdensome inventories and unprofitable market prices for canned tomatoes and tomato products. As processors attempted to realign supplies with consumption, the 1980 contracted acreage dropped 16 percent and the field price fell to about \$47 per ton from \$57 in 1979. Profitability of canned tomatoes began to improve in mid-1980 when it became clear that the year's harvest would reach only about 5.5 million tons. The 1981 crop is expected to be 5 to 5.5 million tons, meaning a second year of decline.

Although tomato contract acreage is down another 3 percent in 1981 (see Table 1) and case prices remain profitable, canners in their early offers indicated that they would not pay producers higher than 1980 prices. Consequently, many growers shifted to alternative crops with lower production costs and higher expected margins, such as wheat and sugar beets. The season's grower return for tomatoes will average about \$50 per ton. However, with the anticipated small crop, tomato canners will have relatively tight supplies of canned tomato products through 1982. This will support continued profitable product prices and create a more favorable bargaining position for growers when they enter 1982 pricing negotiations.

Fruits

The concern of the canning industry has shifted away from tomatoes to canned fruits where weak sales have resulted in excessive inventories and heavy discounting off list prices. As of March 1, 1981, inventories of all the major canned fruits

Table 2. Cash Farm Receipts in California, 1974-1981

Year	Livestock and Livestock Products		Percent Change	Vegetables		Percent Change	Fruits and Nuts		Percent Change	Field Crops		Percent Change	Horticultural Specialties ¹		Percent Change
	(millions)			(millions)			(millions)			(millions)			(millions)		
1974	\$2,786.3		8.6%	\$1,595.8		26.0%	\$1,611.0		-2.2%	\$2,199.2		59.0%	\$420.6		15.1%
1975	2,802.6		0.6	1,695.5		6.2	1,622.9		0.7	1,905.8		-13.3	470.0		11.7
1976	2,922.5		4.3	1,599.5		-5.7	1,742.1		7.3	2,264.6		18.8	549.1		16.8
1977	2,947.9		0.9	1,902.3		18.9	2,098.4		20.5	1,824.9		-19.4	588.2		7.1
1978	3,379.7		14.6	2,035.0		7.0	2,460.9		17.3	1,963.7		7.6	631.0		7.3
1979	4,185.2		23.8	2,110.9		3.7	3,140.3		27.6	2,441.7		24.3	801.7		26.9
1980 ²	4,452.1		6.4	2,110.3		0.0	3,441.2		9.6	2,802.4		14.8	856.4		6.8
1981 ³	4,719.0		6.0	2,289.0		8.5	3,590.0		4.3	3,195.0		14.0	942.0		10.0

¹Includes Forest Products.

²Preliminary.

³Projected.

were at least 20 percent above the previous year's levels and the overall movement was down 2 percent even though canners lowered their case prices. The industry faces especially large inventories of its largest size—No. 10—cans. These are moving slower than usual. This market environment suggests that grower returns could decline from 1980 levels.

Recognizing the potential for a chronic imbalance between production capability and profitable pack levels, the California Canning Peach Association initiated a one-time program, offering an incentive payment of up to \$750 per acre for growers to remove cling peach trees. This program will result in the removal of trees on about 2,300 acres—over 5 percent of total bearing acreage. This bold step is expected to provide some relief in an otherwise gloomy 1981 financial outlook for cling peach growers. The move also will accelerate an otherwise prolonged adjustment of bearing acreage to levels that should yield a fruit pack profitable to growers and canners in the years ahead.

FIELD CROPS CONTINUE TO EXPAND

There has been a noticeable shift of acreage away from vegetable crops toward the less costly to produce field crops. About 200,000 more acres will be planted in the major field crops this year, including about 13,000 acres shifted out of vegetables. Cash receipts from field crops will increase about 14 percent in 1981. Field crops accounting for much

Table 3. Field Crop Plantings in California, 1979–1981 (thousands of acres)

Crop	1979	1980	1981 ¹	Percent Change 1980–1981
Hay (all)	1,560	1,550	1,570	+1%
Cotton	1,650	1,500	1,460	-3
Wheat-Winter	793	1,130	1,350	+19
Barley	900	800	720	-10
Rice	525	552	555	+1
Corn	430	450	445	-1
Oats	350	350	350	0
Sugar Beets	224	234	270	+15
Dry Beans	207	220	200	-9
Wheat-Durum	47	105	170	+62
Sorghum	165	165	160	-3
Totals	6,851	7,056	7,250	+3%

¹Indicated plantings as of March 1.

of this year's acreage increase are wheat, sugar beets, rice, and hay (see Table 3). The shift has been mainly caused by the narrowing returns and the larger seasonal borrowings required for vegetable farming—a factor of considerable weight in a period of high interest rates.

Cropping patterns could be further changed if the problem of the Mediterranean fruit fly (Medfly) infestation continues. Farmers would probably avoid planting crops—such as tomatoes, bell peppers, and melons—which host this pest.

Cotton, the state's leading field crop, will be planted on about 3 percent less acreage than in 1980, partly as a consequence of crop rotation schedules. Cotton prices are expected to be more volatile for the remainder of 1981 due to economic, political, and weather uncertainties. These uncertainties, plus slow economic growth and relatively high interest rates, have caused mills to be more cautious about making forward purchases. Through March 31, only 3 percent of California's cotton crop was covered by forward contracts, compared with 12 percent at the same time last year and an average of 29 percent for the previous eight-year period. More of the price risk, therefore, will be placed on growers, and their decisions about whether to sell at harvest or hold for future sale will have a major impact on market prices.

The same uncertainties affect most of the 1981 grain crops. Smaller than normal percentages of these crops are covered by forward contracts, which make prices more susceptible to growers' marketing decisions and cash requirements at harvest time.

All Crops (millions)	Percent Change	Total Receipts (millions)	Percent Change
\$5,826.6	24.9%	\$8,612.9	19.2%
5,694.2	-2.3	8,496.8	-1.3
6,155.3	8.1	9,077.9	6.8
6,413.8	4.2	9,361.6	3.1
7,090.6	10.6	10,470.3	11.8
8,494.6	19.8	12,679.9	21.1
9,210.3	8.4	13,662.4	7.8
10,016.0	9.2	14,780.0	8.2

AGRICULTURE AND URBANIZATION

Farm Land Values Continue Upward

Despite the high interest rates and volatile commodity prices, California farm real estate values have continued to appreciate at rates well above inflation. In 1980, California farmland and buildings increased in value an average of 22 percent, compared with 10 percent for the nation. Prospects for 1981 are for a continued rise in farm real estate values but at the more modest rate of 10 to 12 percent. Slowing inflation, continued high interest rates, a stronger dollar dampening foreign investment, and a continued cost-price squeeze on agricultural enterprises are a few of the factors that are decelerating appreciation.

The Medfly infestation represents a threat to the unbroken upward trend in land values. If the pest is not eradicated in Alameda and Santa Clara Counties, the prospect of a more widespread infestation could potentially lead to distress sales of fruit orchards and a temporary decline in farm real estate values in many regions. It could also trigger a sense of caution on the part of farm real estate investors when this problem is added to the water, pesticide, and labor issues that continue to confront the state's agricultural landowners.

On the other hand, land values will tend to be pushed higher due to the future development potential accompanying the projected rapid population growth in major agricultural areas. Effectiveness of the Williamson Act, which provides property tax relief to landowners whose acreage is committed to agricultural use, has been lessened as a result of the passage of Proposition 13 and the accompanying decline in property taxes. As more landowners remove their land from the program, the development potential for these parcels will again exert an upward pressure on land values.

Table 4. Population and Housing Increases by Region in California, 1970-1980

	PERCENT INCREASE	
	Population	Housing
Central Coast Region	12.4%	28.6%
Mountain Region	54.0	73.3
North Coast Region	17.0	37.4
Sacramento Valley Region	25.7	51.7
San Joaquin Valley Region	25.0	43.6
Southern California Region	17.2	28.9

Changing Demographic and Economic Patterns

Recent demographic trends are of considerable importance for agriculture in all parts of California. Population and housing growth rates over the past 10 years have been especially high in the Mountain Region and the San Joaquin and Sacramento Valleys (see Table 4). The two Valley areas accounted for about 20 percent of California's total population increase between 1970 and 1980, and contributed the major share of the state's 35 percent growth in nonmetropolitan areas. (Metropolitan growth was only 16.5 percent.) Overall, the state added 17.7 percent to its population during the decade.



Projections of future growth indicate that the population trend observed between 1970 and 1980 can be expected to continue through 1985, although at a slower rate. Growth is expected to be slowest in Southern California and the Central Coast Region, but even here the greatest increases most likely will be in agricultural areas.

Reasons for the faster growth in rural areas are complex, but the major causes can be divided between personal and business decisions. Continuation of the long trend of migration from the cities into the suburbs has pushed the bedroom community boundaries farther outward into the more rural and semi-rural areas. A newer trend reflects the conscious choice of urban dwellers to move to small towns and rural areas in pursuit of more relaxed surroundings and a different style of living. Finally, an increasing number of retirees are leav-

ing the cities, hoping to enjoy better living conditions on their limited incomes.

Business decisions regarding locations for plants and other facilities also have affected, and been affected by, the shifting pattern of population growth. In one sense, business has been a leader in the movement by choosing to open new facilities in rural areas or small towns rather than expanding operations in crowded metropolitan areas. Availability of affordable housing for employees, within reasonable commuting distance, has been a major consideration in these decisions. Conversely, business has also been affected by individual decisions to migrate to rural and small town areas, which are providing an expanding labor force from which to draw employees. As a result, areas such as the Sacramento and San Joaquin Valleys, are among the state's leaders in economic growth. This is in marked contrast to the historic trend in which the highest economic growth has occurred in coastal areas.

A major consequence is that economies of these faster growing areas are becoming more diverse, with agriculture exerting less dominance. This change will likely provide them with greater economic stability and less vulnerability to the vagaries of weather and other factors affecting farm income.

A number of problems, however, are being created. Local governments are finding it necessary to deal with often bitter conflicts over growth

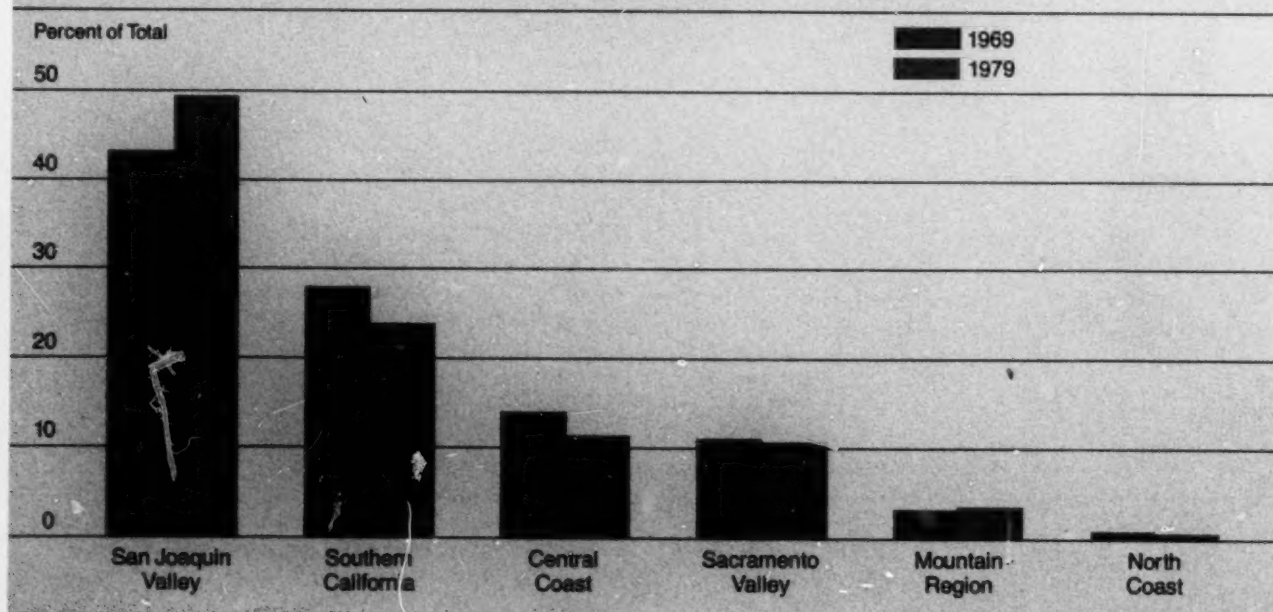
policies. They also must find ways in this post-Proposition 13 era to finance government services needed to meet expanding demands. Established local businesses, too, are expected to experience increasing challenges as a burgeoning population attracts new businesses, thereby creating greater competition. To the extent that new entrants are able to provide goods and services at lower costs, local businesses may have to make major adjustments in their merchandising and pricing practices—or lose out to the competition.

Effects of Migration on Agriculture

For practical purposes, land transfer from agriculture to urban use is a one-way process and agriculture's viability will continue to be affected by the rapid population growth in rural areas. First, as population and nonagricultural businesses expand, the influence of agricultural interests on local government decisions will diminish. Where, historically, agriculture lost influence in Sacramento and Washington, D.C., due to the movement of people away from the farms to the cities, it is currently losing local influence due to the reverse migration and competing interests of the new inhabitants.

A second and immediate effect on agriculture is the increasing competition for land, creating further upward pressure on farmland prices. While higher prices are a boon to those selling, and while they increase the estate values for current

FIG. 2 PERCENT OF GROSS AGRICULTURAL PRODUCTION VALUE BY REGION IN CALIFORNIA, 1969 AND 1979



owners, they inhibit acquisition of land by young farmers and others with limited capital who wish to use it for farming or ranching. This will lead to a growing separation of ownership from the farming of land, with an increase in farm leasing and other tenancy arrangements. In addition, current owners are increasingly forming family corporations with the intent of avoiding the forced sale of farmland assets to pay inheritance taxes, thus allowing transfer of the property to succeeding generations.

Third, as land is converted from agricultural to urban uses, cultivated acreage can be expected to decrease. Increased yields, however, due to

tion are becoming evident (see Figure 2 and Table 5). Part of the increased importance of the San Joaquin Valley can be attributed to urbanization of the traditional agricultural areas surrounding Los Angeles, San Diego, and the San Francisco Bay Area.

While political pressures for statewide land use planning legislation will mount over time, the problem is currently too politically sensitive to expect such a proposal to succeed in the near future. There is no general agreement on the severity of farmland conversion or on feasible solutions to the problem. Consequently, land use planning is likely to continue for some time on a county-by-county basis.

A further implication from the population shift is that farm management decisions are increasingly subject to environmental concerns of nonfarmers. Chemical spraying, manure handling, and other aspects of agricultural operations are subject to these concerns.

Finally, the availability and use of water are becoming increasingly critical issues. Because of its economic importance within the state, water has historically been a politicized commodity, and this is being intensified by a growing rural population. Development of projects to store and transport water, along with the issues of availability and allocation, will remain a source of conflict in the 1980s.

As California's traditional agricultural areas become increasingly urban, competition will grow for land, water, and other resources critical to the continued viability and growth of agriculture in the state. Unless profitability of food and fiber production increases or legal prohibitions against the shift of land out of agriculture are enacted, California's agricultural land will continue to be diverted to other uses. During the 1980s, the priorities of land and resource use will be debated—increasingly and heatedly. The outcome will have significant impact not only on agricultural interests but on all Californians.

Table 5. Dollar Levels and Percent Increase in Gross Value of Agricultural Production by Region, 1969 and 1979

(Dollars in Millions)	1969	1979	Percent Change
Central Coast	\$ 650.9	\$ 1,664.0	155.6%
Mountain	143.5	469.0	226.7
North Coast	36.5	99.5	172.6
Sacramento Valley	513.4	1,533.1	198.6
San Joaquin Valley	2,001.2	7,047.6	252.6
Southern California	1,287.3	3,423.1	165.3
Totals for State	\$4,634.8	\$14,236.2	207.0%

better management techniques and scientific/technological advances, will moderate production losses. For land remaining in agricultural use, rising land prices will force changes in the crop mix, with greater emphasis on crops that exploit California's comparative production and marketing advantages.

Although the state's gross agricultural output continues to grow, shifts in each region's contribu-

This report was prepared by the Economics-Policy Research Department of Bank of America NT&SA. The bank, which was founded in 1904 by A. P. Giannini, is the nation's largest lender to agriculture among U.S. commercial banks. Among its activities related to agriculture, the bank finances farm real estate, equipment, crop and livestock production, food processing, and export.

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